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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 680

IRVING J. REUTER,

Petitioner,

vs.

THE UNITED STATES.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS AND BRIEF IN SUPPORT THEREOF.

JAMES A. COSGROVE,
Counsel for Petitioner.

INDEX.

Subject Index.

	Page
Petition for writ of certiorari	1
A. Summary statement of the matter involved	1
B. Relevant parts of statutes involved	3
C. Questions presented	4
D. Reasons for granting the petition	5
Brief in support of petition	9
I. The opinion of the court below	9
II. Statement as to the jurisdiction	9
III. The questions involved	10
IV. Assignments of error	10
V. Argument	11
1. The Court of Claims erred in failing to decide that the Janirv trust was not a trust, the income of which is taxable to the grantor by reason of the provisions of Section 166 of the Revenue Act of 1934	11
2. The Court of Claims erred in deciding that the income of the Janirv trust was taxable to the grantor thereof under the provisions of Section 22(a) of the Revenue Act of 1934 and the rule laid down by this Court in *Helvering* v. *Clifford*, 309 U. S. 331, on the grounds that the Janirv trust was lacking in substance and the grantor's control of the trust corpus was such as to require that he be considered the owner thereof	14
3. The Court of Claims erred in deciding that the income of the Janirv trust was taxable to the grantor thereof under Section 22(a) of the Revenue Act of 1934 because such	

Page

an application of said section for the purpose of taxing the grantor of a valid trust on income distributable to other persons would be unconstitutional 19

CASES CITED.

Brushaber v. *Union Pacific Railroad Co.*, 240 U. S. 1 20
Burnet v. *Wells*, 289 U. S. 670 15
Corning v. *Commissioner*, 104 F. (2d) 329 12
Dupont v. *Commissioner*, 289 U. S. 685 15
Eisner v. *Macomber*, 252 U. S. 189 20
Helvering v. *Wood*, 309 U. S. 344 13
Helvering v. *Clifford*, 309 U. S. 331 ..... 2, 4, 5
Hoeper v. *Tax Commission of Wisconsin*, 284 U. S. 206 7
I. J. Reuter v. *Commissioner*, B. T. A. Memo. Op., July 30, 1940 6
Nichols v. *Coolidge*, 274 U. S. 531 7

LAW AND STATUTES CITED.

Constitution of United States, Sixteenth Amendment 20
Constitution of the United States, Fifth Amendment 20
Judicial Code, Section 145 10
Judicial Code, Section 240, as amended February 13, 1925, and May 22, 1939, 53 Stat. 752 10
Revenue Act of 1934:
Section 22(a) 3
Section 161 3
Section 166 4
Section 167 4

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THE UNITED STATES.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

To the Honorable Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner, Irving J. Reuter, respectfully shows unto this Honorable Court as follows:

This is a petition for a writ of certiorari to the Court of Claims of the United States to review a judgment made and entered in that court on October 7, 1940.

A.

Summary Statement of the Matter Involved.

Petitioner filed with the Court of Claims of the United States on January 18, 1939, a petition praying for judgment against the United States in the sum of $11,800.69.

This claim was based upon the contention that individual income tax and interest in this amount for the year 1934 had been erroneously and illegally collected by the Collector of Internal Revenue for the District of Michigan at Detroit, Michigan.

The aforesaid amount of income tax and interest had been paid by petitioner on March 3, 1938, as a result of an assessment made against him by the Collector of Internal Revenue for the District of Michigan. This assessment consisted of a deficiency in 1934 income tax in the principal amount of $10,038.93 made on the ground that certain income received during 1934 by the Jan-Irv Trust Fund, of which petitioner was the grantor, was taxable to the grantor. The remainder of the assessment consisted of interest on this deficiency.

On March 21, 1938, petitioner filed a claim for refund of the aforesaid deficiency and interest with the Collector of Internal Revenue for the District of Michigan. This claim was based on the ground that petitioner was not liable for taxation on the income of the Jan-Irv Trust Fund under Section 166 of the Revenue Act of 1934, since the trust was irrevocable and the income in question was currently distributable to named beneficiaries other than petitioner. No action having been taken on this claim for a period in excess of six months, the petitioner filed his suit with the Court of Claims of the United States as above stated.

On October 7, 1940, the Court of Claims made its special findings of fact and conclusion of law and in its opinion held that the instant case was governed by the principle established by this court in *Helvering* v. *Clifford,* 309 U. S. 331. Accordingly, the court held that petitioner was taxable on the income of the Jan-Irv Trust under the provisions of Section 22(a) of the Revenue Act of 1934. The Court of Claims deemed it unnecessary to discuss the applicability of Section 166 of the Revenue Act of 1934 to the case at bar.

B.

Relevant Parts of Statutes Involved.

The statutes involved in this proceeding are Section 22(a), Section 161 and Section 166 of the Revenue Act of 1934, the relevant parts of which are as follows:

"Sec. 22. GROSS INCOME.

(a) GENERAL DEFINITION. 'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *"

"Sec. 161. IMPOSITION OF TAX.

(a) APPLICATION OF TAX. The taxes imposed by this title upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust.

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary may be either distributed to the beneficiaries or accumulated.

(b) COMPUTATION AND PAYMENT. The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor.)"

"Sec. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor."

C.

Questions Presented.

The questions presented by this petition are:

1. Whether Section 22(a) of the Revenue Act of 1934 requires the taxation to the grantor of the income of a trust irrevocable during the year in question and only contingently revocable in the future, where such income is required to be currently distributed to persons other than the grantor.

2. Whether the Court of Claims of the United States erred in extending the principle of *Helvering* v. *Clifford*, 309 U. S. 331, to such a trust, despite the fact that the trust did not terminate by its own terms and recovery of the corpus by the grantor was purely contingent.

3. Whether the taxation of the income of trusts such as that involved in this proceeding is to be determined by application of Section 161 of the Revenue Act of 1934 rather than Section 22(a) of said Act.

D.

Reasons for Granting the Petition.

1. The Court of Claims of the United States has erred in extending the rule laid down by this Court in its decision in the case of *Helvering* v. *Clifford, supra,* to the grantor of a trust, differing in material respects from the trust which was before this Court in that case. In the *Clifford* case this Court had before it a trust, the term of which was limited to five years, created by a trust instrument which provided that upon the expiration of this brief term the corpus of the trust should revest in the grantor. During the life of the trust the grantor, as trustee, exercised unusually broad and extensive powers of management and control, not only of the investment policy of the trust, but likewise over the distribution of the income. The beneficiary of the trust was the grantor's wife. On these facts this court decided that the income of the trust was taxable to the grantor as a part of his own gross income and as one of the items of gross income enumerated and covered by the provisions of Section 22(a) of the Revenue Act of 1934. This was, in effect, a determination that the trust itself was without substance and that the trust corpus remained, from the point of view of economic realities and for the purposes of taxation, a part of the property of the grantor.

In the instant proceeding the Court of Claims has attempted to extend this principle to a trust which had substance. The declaration of trust of the Jan-Irv Trust provided that the trust should be irrevocable for a period of at least five years. Upon the expiration of this period the grantor, if living, had power to terminate the trust, pro-

vided, however, that notice of termination had been given at least thirty days prior to such expiration. On the failure of such notice or the failure of the grantor to survive the five-year period, the trust was to continue irrevocably for an additional five years, at the expiration of which extended period the corpus was to be distributed to persons other than the grantor.

The decision of the Court of Claims threatens the extension of the principle of the *Clifford* case to trusts possessing real substance, the creation of which effected a real and substantial diminution of the economic rights of their grantors, merely by reason of their limited term. The effect of such an extension is to expand the class of trusts whose income the Congress determined should be taxable to the grantors thereof by enacting the specific provisions of Section 166. Such a threatened extension creates a situation which renders appropriate the intervention of this Court.

2. The identical issue involved in this proceeding is now pending before the United States Circuit Court of Appeals for the Fifth Circuit on an appeal from a decision of the United States Board of Tax Appeals. The case in the Fifth Circuit (*Irving J. Reuter* v. *Commissioner,* B. T. A. Docket 96843, petition for review filed October 31, 1940) involves the same taxpayer and the same trust as the instant proceeding but relates to income for years following 1934, the year here in question. In the event that the taxpayer is sustained in his appeal to the Circuit Court of Appeals for the Fifth Circuit, there will be a conflict between the decision of that court and the decision of the United States Court of Claims in the instant proceeding. Such a conflict would warrant the intervention of this Court, which is only possible if the present petition is granted.

3. The Court of Claims has erred in determining that the petitioner herein should be subject to taxation in respect to income which could neither be distributed to him, used

for his benefit, nor accumulated for future distribution to him. The court has erred in determining that petitioner should be treated as the real owner of the corpus of a trust, despite the fact that such corpus could revert to him only on the happening of contingencies in the future, in the absence of which distribution of the corpus to named remaindermen was required. It is apparent that error was committed in determining that petitioner, in these circumstances, "retained the substance of full enjoyment of all the rights which previously he had in the property" and that the Court of Claims has disregarded the fundamental equity of the rule that one taxpayer should not be taxed upon the income of another. See *Nichols* v. *Coolidge*, 274 U. S. 531; *Hoeper* v. *The Tax Commission of Wisconsin*, 284 U. S. 206.

WHEREFORE your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the Court of Claims of the United States, commanding that court to certify and to send to this Court for its review and determination on a day certain to be designated, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket *Irving J. Reuter*, Plaintiff, v. *The United States*, Defendant, No. 44588, and that the judgment of the Court of Claims of the United States may be reversed by this Honorable Court and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

And your petitioner will ever pray.

IRVING J. REUTER,
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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 680

IRVING J. REUTER, *Petitioner,*

vs.

THE UNITED STATES.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

I.

The Opinion of the Court Below.

The opinion and judgment of the Court of Claims of the United States in this proceeding was entered October 7, 1940, and is published in 34 Fed. Supp. 1014.

II.

Statement as to the Jurisdiction.

The jurisdiction of this Court is invoked on the following grounds:

1. The judgment to be reviewed was originally entered by the Court of Claims on October 7, 1940. Time to apply for a writ of certiorari runs from that date.

2. In this case plaintiff sued in the Court of Claims to recover from the United States the amount of an income tax deficiency and interest thereon under authority of Section 145 of the Judicial Code.

3. This Court has jurisdiction to grant certiorari under Section 240 of the Judicial Code as amended by the acts of February 13, 1925, and May 22, 1939, 53 Stat. 752.

III.

The Questions Involved.

The question immediately involved in this proceeding is whether Section 22(a) of the Revenue Act of 1934 requires that the grantor of a trust be taxed on the income thereof where the trust is irrevocable for a period of years, is subject to revocation in the future only upon the happening of certain contingencies, where the income is payable to beneficiaries other than the grantor and where, if not revoked, the corpus is distributable to named remaindermen other than the grantor. By implication, decision of this question involves a determination whether such a trust is without substance and whether its corpus is to be treated as the property of the grantor, with the result that the grantor must pay tax on income which he never receives and which is derived from property which he has transferred, perhaps permanently, subject only to a contingent revestment.

IV.

Assignments of Error.

1. The Court of Claims erred in failing to decide that the Janirv Trust was not a trust, the income of which is taxable to the grantor by reason of the provisions of Section 166 of the Revenue Act of 1934.

2. The Court of Claims erred in deciding that the income of the Janirv Trust was taxable to the grantor thereof under the provisions of Section 22(a) of the Revenue Act of 1934 and the rule laid down by this Court in *Helvering v. Clifford,* 309 U. S. 331, on the grounds that the Janirv Trust was lacking in substance and the grantor's control of the trust corpus was such as to require that he be considered the owner thereof.

3. The Court of Claims erred in deciding that the income of the Janirv Trust was taxable to the grantor thereof under Section 22(a) of the Revenue Act of 1934 because such an application of said section for the purpose of taxing the grantor of a valid trust on income distributable to other persons would be unconstitutional.

V.

ARGUMENT.

1. The Court of Claims erred in failing to decide that the Janirv trust was not a trust, the income of which is taxable to the grantor by reason of the provisions of Section 166 of the Revenue Act of 1934.

The income tax deficiency and interest paid by Irving J. Reuter, your petitioner, which was sought to be recovered in a suit instituted in the Court of Claims of the United States, was originally assessed against petitioner under authority of Section 166 of the Revenue Act of 1934. Plaintiff's initial contention is that this Section has no application to the income of such a trust as is involved in this proceeding. The Court of Claims in its decision failed, however, to pass on this question.

Section 166 provides that the income of a trust shall be taxed to the grantor where the grantor has a power to require the revestment of the corpus of the trust in him-

self. In the instant case, however, the grantor early in 1932 created a trust which was to be irrevocable for a period of five years from and after January 1, 1932, and merely provided that he should have the right to terminate the trust after the expiration of this five-year period provided notice in writing of such election to terminate should have been served upon the beneficiaries at least thirty days prior to the expiration of the period. In the event that the grantor did not survive the minimum life of the trust or failed to give proper notice of his intention to terminate, the trust was to continue for an additional period of five years and upon termination, its corpus was to be distributed to remaindermen other than the grantor.

It is apparent that the grantor in the instant case did not retain any power through the exercise of which he could have secured a retransfer to himself of title to the trust corpus at such time as to permit him to enjoy any income which the trust might receive during 1934. The income of this trust was designated irrevocably to be paid to the named beneficiaries, not including the grantor, for a period of at least five years.

Furthermore, it is apparent that the grantor under the terms of the Declaration of Trust was not "vested" with any "power" to secure the revestment of title to the trust corpus in himself. A power that cannot be exercised is not a power at all or is at most only a contingent power. *Corning* v. *Commissioner,* 104 F. (2d) 329.

It was necessary that a period of five years elapse before the grantor of the Janirv Trust Fund could exercise any power to terminate the trust. A power which can only be exercised after a lapse of years is contingent upon the grantor surviving until the period has passed. If the grantor failed to survive, his contingent or inchoate power to revest would never become an actual exercisable power

and, by the terms of the trust instrument, the corpus would be distributable to an irrevocably named person. It may be noted that the grantor did not retain any rights to change the named beneficiaries or to exercise any power of appointment over the trust corpus by will or otherwise. Consequently, it was only in the event of his surviving the five-year period that he was able to acquire any right through the exercise of which he might either secure the revestment of the trust property in himself or direct its disposition to others. Accordingly, the "power" possessed by the grantor in the instant case is at most a "contingent" or "inchoate" power and accordingly within the rule of the *Corning* case, cited above.

Therefore, in the instant case, the grantor was not *vested* with any *power* to revest the *corpus* of the trust in himself within the meaning of Section 166 of the Revenue Act of 1934. This is the conclusion reached by the Board of Tax Appeals in interpreting the identical trust instrument here involved in the case of *I. J. Reuter* v. *Commissioner,* B. T. A. memorandum opinion entered July 30, 1940. The Board's opinion in this case is based upon the decision of this Court in *Helvering* v. *Wood,* 309 U. S. 344.

Finally, since there is no provision in the trust instrument for the accumulation of that portion of trust income the taxation of which is here in question, and since the income is not to be used to pay any obligations of the grantor, to pay insurance premiums on his life or to be used in any way for his benefit, it is accordingly clear that Section 167 of the Revenue Act of 1934 does not apply. It follows that the petitioner is not taxable as grantor of the trust in respect to the income of the trust and that the tax which he paid in respect to such income should be refunded to him. The Court of Claims of the United States was in error in failing to so decide.

2. The Court of Claims erred in deciding that the income of the Janirv Trust was taxable to the grantor thereof under the provisions of Section 22(a) of the Revenue Act of 1934 and the rule laid down by this Court in Helvering v. Clifford, 309 U. S. 331.

The decision of the Court of Claims of the United States rests solely upon the determination that the instant proceeding is governed by the decision of this Court in *Helvering* v. *Clifford, supra.* Your petitioner, however, contends, first, that the decision in this case did not establish any general principle that the income of all short-term trusts should be taxed to the grantors thereof, even where the grantor and the trustee were a single person; and, second, that the facts of the instant proceeding are different in material respects from the facts in the *Clifford* case and warrant the application of a different rule.

In the first place, it may be noted that the Revenue Act of 1934 provides for the taxation of trust income under Sections 161 and 162, subject to exceptions (requiring taxation of the income to the grantors of trusts) contained in Sections 166 and 167. Sub-Title B of the Act of which Section 22(a) is a part provides for the taxation of individuals and contains no reference whatever to trusts or the income of trusts. It follows that the determination of this Court that the income of the trust in the *Clifford* case was taxable to the grantor thereof by reason of the provisions of Section 22(a) is equivalent to a determination that in the *Clifford* case, to all intents and purposes, no trust existed. To tax the income of a trust to the grantor "under Section 22(a)" is to say that the trust is so lacking in substance and reality as to leave the *corpus* of the trust throughout its term essentially the property of the grantor.

Your petitioner therefore believes that this Court in its decision in the *Clifford* case was not establishing a general

principle that the income of all short-term or vested-term trusts should be taxed to the grantors thereof. Such a principle in its very nature would be repugnant to the entire structure and purpose of the revenue statutes of the United States.

In numerous cases this Court, in dealing with the taxation of trust income, has found—based upon the special facts of the cases involved—that the grantor had failed to relinquish dominion and control over the *corpus* of the trust which he had purported to create to a sufficient degree to establish a valid trust. The conclusion naturally followed that, if the grantor remained in effect the owner of the *corpus*, the liability for the payment of tax on the income from the *corpus* remained upon him. See *Burnet* v. *Wells*, 289 U. S. 670; *Dupont* v. *Commissioner*, 289 U. S. 685.

From this it follows that the decision in the *Clifford* case should be treated by lower courts as having been based upon the special facts presented to this Court in that case. The decision of the Court of Claims in the instant case rests upon an analysis of the special facts of the instant case. In spite, however, of the wide divergencies in the facts of this case and the *Clifford* case, the Court of Claims held—petitioner maintains erroneously—that the two cases "are similar in all respects and the provisions in the two trusts are almost indistinguishable". Petitioner believes that this finding constitutes error.

The entire structure and phraseology of the Declaration of Trust in the *Clifford* case suggests an intention on the part of the grantor to relinquish as little control as possible over the property involved. The grantor begins not by explicitly transferring or conveying the property in question to a trustee but merely by stating "I * * * do hereby acknowledge and declare that I do and will hold all of the same (referring to the property in question) and all my right, title and interest therein as a trust estate

* * *." He then proceeds to declare that the income of the trust estate shall be held for the exclusive benefit of his wife, but provides that he as trustee may distribute such income or any part of it to her at any time or withhold all of such income as he may determine. Upon the termination of the trust at the expiration of its five-year period, the undistributed net income "shall be deemed and treated as property owned absolutely by" the beneficiary, although there is no provision for its distribution to her.

Moreover, the structure of the *Clifford* trust indicates the full intention of the grantor to resume ownership of the *corpus* on termination. The trust was to terminate in five years or upon the prior death of either the grantor or his wife. Upon termination, however effected, the principal of the trust "shall be deemed and treated as property owned absolutely by me". This provision is not altered to take account of the possible termination of the trust as a result of the death of the grantor himself. Even in this event, the trust *corpus* would not go over to the beneficiary. The instrument of course contains no provision for the appointment of a successor trustee or any provision looking to a possible continuation beyond the five-year period. On the contrary, at the expiration of such period "the trust hereby created shall forthwith and without any further act or deed terminate".

Finally, the grantor in the *Clifford* trust reserves to himself such unusually extensive powers of control over the trust *corpus* as to explain the conclusion of this Court that he intended to retain the right to treat the trust property substantially as if it were his own. He retained the right to exercise all voting powers of stocks in the trust; to keep the registry in his own name or in the names of his nominees; to dispose of any assets freely upon any terms determined by himself; to invest the proceeds in any sort of personal property whatsoever "* * *, without restriction because of the speculative character of the investment or the rate

of return therefrom or any laws pertaining to the investment of trust funds"; and to lend such proceeds "with or without security". These powers were coupled with a provision relieving the trustee of liability to the life beneficiary for any loss of any kind, except resulting from willful and deliberate violation of the terms of the trust. Finally, it may be noted that the grantor's control of the income, which was absolute during the five-year period, is extended by the provision that not only stock dividends and proceeds from the sale of subscription rights but also "extraordinary cash dividends", should be excluded from income and should become part of the corpus, to be returned to the grantor upon the termination of the trust.

It was on the basis of the foregoing facts that this Court concluded:

> "In this case we cannot conclude as a matter of law that respondent ceased to be the owner of the corpus after the trust was created. * * * So far as his dominion and control were concerned it seems clear that the trust did not effect any substantial change."

In the present case we are dealing with a trust of materially and substantially different character. The Janirv Trust was to continue irrevocably for a period of five years but, unlike the trust in the *Clifford* case, would not terminate at the expiration of five years unless prior notice had been given by the grantor. In the absence of such notice, the trust became absolutely irrevocable at the end of the five-year period. It is apparent that the grantor contemplated such continuance, since he provided in the Declaration of Trust for the appointment of successor trustees and included provisions relating to their powers and authority. Likewise, he provided that if he did *not* survive the minimum life of the trust, the trust should nevertheless continue and, upon termination, the property should be distributed to named remaindermen. From all of the foregoing it is entirely clear that petitioner, in establishing the Janirv Trust,

parted with his individual control of the property constituting the corpus of the trust and subjected that property to the fixed control of the provisions of the instrument, which not only deprived him definitely of all rights to the current income, but under certain contingencies would have completely alienated his ownership in the corpus itself.

Even more significant perhaps, the grantor did not retain the quality of control over the income of the trust which is present in the *Clifford* case. The trust instrument required that the income from the General Motors Securities Company stock (the only portion of the income here in question) *had* to be distributed currently to the beneficiaries. As to such distribution, the grantor retained no option or any form of control over the income of the trust. Moreover, these beneficiaries included not only plaintiff's wife but also his parents and it is clear that one significant purpose of the trust was to provide in all events an income for these parents. They are protected in the enjoyment of this income even if the trust terminates by reason of the deaths of the grantor and his wife. It certainly cannot be said here, as in the *Clifford* case, that the trust was "at best a temporary reallocation of income within an intimate family group".

Finally, the trust powers retained by the grantor in the Declaration of Trust of the Janirv Trust were merely the normal powers incident to a relationship of trusteeship. The trustee was given the right to sell and transfer the property and was required to reinvest the proceeds of sale, his investment power being limited to "income-producing securities". He was empowered to divide the trust estate in kind upon termination and to compromise and settle claims and was required to provide proper annual reports of the financial transactions of the trust. These are normal trust powers and duties such as are to be found, of necessity, in substantially every trust instrument.

Your petitioner submits that they are not powers of such

unusual character as to warrant the characterization of the Court of Claims contained in the statement: "Broad and almost unlimited powers were bestowed upon the trustee to deal with the trust property upon such terms and conditions as he deemed best." On the contrary, it is submitted that it is impossible to say in the instant case, as this Court said in the *Clifford* case, that plaintiff "retained the substance of full enjoyment of all the rights which previously he had in the property". Specifically, here the grantor was limited in the type of investments he could make; was required to keep the corpus invested; was required to render annual statements, and, most important of all, was required to pay the income currently to the life beneficiaries.

In view of all the foregoing, petitioner denies that the facts of this case bring it within the rule of the *Clifford* case and submits that the Court of Claims was in error in so holding.

However, if petitioner did not "retain the substance of full enjoyment" of the trust corpus, but on the contrary parted with substantial rights to the income of the trust and subjected himself to the possibility of the permanent alienation of ownership of the property involved, then a true trust was created and Section 22(a) of the Revenue Act of 1934 has no application whatsoever to the taxation of its income.

3. The Court of Claims erred in deciding that the income of the Janirv Trust was taxable to the grantor thereof under Section 22(a) of the Revenue Act of 1934 because such an application of said section for the purpose of taxing the grantor of a valid trust on income distributable to other persons would be unconstitutional.

Finally, petitioner submits that the decision of the Court of Claims in the instant proceeding involves an application of Section 22(a) which is contrary to provisions of the Con-

stitution of the United States. The power of Congress to levy an income tax is not an unrestricted power. It arises by virtue of the Sixteenth Amendment to the Constitution which permitted Congress "to lay and collect taxes on incomes from whatever source derived without apportionment among the several States or without regard to any census or enumeration". Congress cannot under the authority of the Sixteenth Amendment levy a tax under the guise of an income tax on that which is not income. *Eisner* v. *Macomber,* 252 U. S. 189.

Clearly, however, the term "income" connotes not only an amount of money or wealth received, but also a recipient. To levy an income tax is to impose a liability upon a taxpayer on account of his receipt of income and not the receipt of income by someone else. Income is "income" only to its own recipient. Stated otherwise, a tax on A measured by B's income is not an income tax. *Hoeper* v. *Tax Commission of Wisconsin,* 284 U. S. 206; *Nichols* v. *Coolidge,* 274 U. S. 531.

This Court has not hesitated to hold that an arbitrary and capricious impost under the guise of the exercise of the taxing power was not "the exertion of taxation but confiscation of property, that is, a taking of the same in violation of the Fifth Amendment". *Brushaber* v. *Union Pacific Railroad Company,* 240 U. S. 1. But what can be more arbitrary and capricious than imposing a tax on the grantor of a trust in respect to income of the trust which he does not receive, which has not been used for his benefit but has been distributed to the trust beneficiaries and which he is utterly unable to secure to himself by any act whatsoever which it is within his legal right to do?

Nevertheless, such is necessarily the result of the establishment of any principle that the income of short-term trusts is by reason of Section 22(a) of the Revenue Act of 1934 to be taxed to the grantors thereof. Such an applica-

tion of the statute would, it is submitted, render it unconstitutional and would constitute an arbitrary exercise of power repugnant to the terms of the Fifth Amendment and wholly beyond the scope of the Sixteenth Amendment.

WHEREFORE it is respectfully urged that the petition of Irving J. Reuter for writ of certiorari to the Court of Claims of the United States filed herewith be granted by this Honorable Court in order that the erroneous interpretation of the Court of Claims of the decision of this Court in *Helvering* v. *Clifford, supra,* may be corrected and in order that an improper and unconstitutional application of Section 22(a) of the Revenue Act of 1934 may be avoided.

Respectfully submitted,

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INDEX

	Page
Opinion below	1
Jurisdiction	1
Question involved	1
Statute involved	2
Statement	2
Argument	5
Conclusion	7

CITATIONS

Cases:	
First Nat. Bank of Chicago v. *Commissioner*, 110 F. (2d) 448	6
Helvering v. *Clifford*, 309 U. S. 331	5, 6, 7
Reuter v. *Commissioner*, decided July 30, 1940	7
Statutes:	
Revenue Act of 1934, c. 277, 48 Stat. 680	2
Sec. 22 (U. S. C., Title 26, Sec. 22)	2
Sec. 166 (U. S. C., Title 26, Sec. 166)	7

292468—41

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 680

IRVING J. REUTER, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the court below (R. 14–17) is reported in 34 F. Supp. 1014.

JURISDICTION

The judgment of the court below was entered October 7, 1940 (R. 25). The petition for writ of certiorari was filed January 6, 1941 (R. 25). The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925, as amended by the Act of May 22, 1939.

QUESTION INVOLVED

Petitioner declared himself trustee of certain securities for the benefit of his wife and parents, reserving the right to terminate the trust at the

expiration of five years and retaining broad powers of control over the corpus. The question is whether the income of the trust for the year 1934 is taxable to petitioner.

STATUTE INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly.
>
> * * * * *

(U. S. C., Title 26, Sec. 22.)

STATEMENT

The special findings of fact of the Court of Claims (R. 8–13) may be summarized as follows:

Petitioner established a trust in February 1932, called "The Janiry Trust Fund", of which he designated himself trustee. The trust consisted of various securities which petitioner then owned, including 13,527 shares of stock of the General Motors Securities Company. The declaration of trust provided that the income from the General Motors Securities stock should be distributed nine-tenths to petitioner's wife, not to exceed $30,000 in any year, and one-tenth to his mother and father, not to exceed $3,000 in any one year; and that any income in excess of this amount should become part of the corpus of the trust (R. 8–9). The trust was to be irrevocable for a period of five years from January 1, 1932, but it was to terminate at any time after the expiration of such period if the petitioner gave notice of termination at least thirty days prior to January 1, 1937. If the petitioner died before January 1, 1937, or failed to give notice of termination, the trust was to continue until January 1, 1942, at which time it was to terminate and the property was to be paid over to the petitioner's wife, with a provision for the payment of $3,000 per annum to petitioner's parents for life. If the petitioner's wife should die prior to the termination of the trust and the petitioner survive her, the trust was to continue in full force and effect and the income otherwise distributable to her was, in the absolute discretion of the trustee, either to accumulate and

become corpus of the trust, or to be distributed to the petitioner or his parents (R. 10–11).

The trustee had power to sell, assign, encumber or convey the property in the trust as he deemed best without obtaining any order of court for such action and without regard to whether or not the securities purchased constituted proper and legal trust investments under the applicable state law. The trustee was not to be held liable for any loss except loss resulting from bad faith or willful neglect (R. 11).

The trust instrument further provided that the trustee was authorized in his sole discretion to invade the corpus of the trust for the benefit of the beneficiaries or their families, at any time that, in his judgment, their proper maintenance and support required such action (R. 11). It also provided that no part of the trust estate should be subject to transfer by any beneficiary or be liable in any manner for any debt of any beneficiary (R. 11–12). In the event of petitioner's death before termination of the trust, his wife was to become the trustee (R. 25).

In his income tax return for 1934, petitioner did not report any of the income received by the trust. Subsequently he consented to the assessment of a deficiency of $1,258.19, representing the tax on income for the year 1934 accumulated by the trust. Petitioner paid that deficiency and it is not in issue in this case (R. 12). The present contro-

versy concerns a deficiency of $10,038.93 assessed against petitioner, representing the tax on income received by the trust during the year 1934 and paid over to the beneficiaries. Petitioner paid this deficiency, with interest, filed a claim for refund which was rejected, and then brought suit in the Court of Claims. The court sustained the action of the Commissioner in assessing the deficiency and accordingly dismissed the petition (R. 12–13).

ARGUMENT

This case, as the court below held (R. 15–17), falls directly within the decision of this Court in *Helvering* v. *Clifford,* 309 U. S. 331. Although the trust instruments in the two cases differ in some details, the determinative fact here, as there, is that the taxpayer "retained the substance of full enjoyment of all the rights which previously he had in the [trust] property" (309 U. S. at 336). The grantor himself was the trustee and, as such, he exercised broad powers of control over the administration of the trust, including the investment and reinvestment of its funds; he was to be liable for no loss other than loss occasioned by his bad faith or willful neglect. The beneficiaries of the trust were his wife and parents, the natural objects of his bounty. He had a right to terminate the trust at the end of five years. In the meantime, in his sole judgment as trustee, he could declare that any beneficiary or any member of the family of any beneficiary—and this would include

himself—was in need of funds "by reason of illness, misfortune or any other emergency" (R. 21) and could thereupon sell whatever portion of the trust property he deemed necessary and deliver the proceeds to the needy beneficiary or member of the family. In view of these provisions of the trust, it is plain that the declaration of trust here, as in the *Clifford* case, amounted at best to a "temporary reallocation of income within an intimate family group" (309 U. S. at 335).

The fact that a small part of the trust income in this case was to be paid to petitioner's father and mother, while all the income in the *Clifford* case was to be paid or held for the benefit of the taxpayer's wife, is not a distinguishing factor of substance. Compare *First National Bank of Chicago* v. *Commissioner,* 110 F. (2d) 448 (C. C. A. 7th), where the rule of the *Clifford* case was applied to a trust created for the benefit of the grantor's brother and sister, and the widow of a deceased brother. While the grantor in the *Clifford* case was not required to distribute income to the beneficiary, except such amounts as he deemed best, any undistributed or accrued income and any proceeds from the investment of such income were to be treated as property of the beneficiary. Thus the taxpayer there, as here, could not use any trust income for his own benefit.

The Board of Tax Appeals has considered the taxability of the income of the trust here involved

for other years and has reached the same conclusion as did the court below. *Reuter* v. *Commissioner,* memorandum opinion of the Board of Tax Appeals, decided July 30, 1940, unreported, now pending on appeal to the Circuit Court of Appeals for the Fifth Circuit.

The decision in the *Clifford* case made it unnecessary for the Court of Claims to consider the applicability of Section 166 of the Revenue Act of 1934, and forecloses the contention that the application of Section 22 (a) in these circumstances is unconstitutional.

CONCLUSION

The decision of the court below is in accord with the decision of this Court in *Helvering* v. *Clifford*, 309 U. S. 331. There is no conflict of decisions. The petition should therefore be denied.

Respectfully submitted.

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